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APPLICATION OF

**THE POTOMAC EDISON COMPANY
D/B/A ALLEGHENY POWER**

CASE NO. PUE-2002-00322

**To revise its cogeneration tariff
pursuant to PURPA § 210**

REPORT OF HOWARD P. ANDERSON, JR., HEARING EXAMINER

February 6, 2003

On June 12, 2002, the Potomac Edison Company d/b/a Allegheny Power (“AP” or “Company”), filed an application with the State Corporation Commission (“Commission”) to change its cogeneration and small power production rates under its Schedule CO-G. The Company proposes to revise its Schedule CO-G to replace its administratively-determined avoided cost pricing methodology with a market-based pricing methodology for determining the Company’s payments to qualifying generating facilities (“QF”) for electricity purchased under the Public Utility Regulatory Policies Act of 1978 (“PURPA”).

In support of its proposed rate schedule, the Company states in its application that there have been significant changes in Virginia’s energy markets since the Commission last reviewed the Company’s cogeneration rates. In particular, the Company points to the passage of the Virginia Electric Utility Restructuring Act by the General Assembly in 1999 and the Commission’s approval of the Company’s plan for functional separation. Under its functional separation plan, the Company transferred ownership of all of its electric generating facilities to an affiliate, Allegheny Energy Supply, LLC. The Company states that it has no plans to build generation and, in the future, will purchase electric generation supply to meet its needs.

On August 15, 2002, the Commission entered an Order Establishing Proceeding and Inviting Comments and Requests for Hearing (“Order”) allowing the Company to effect its proposed tariff on an interim basis pending final order in this case. The Order docketed the matter, ordered the Company to provide public notice of its application, established a procedural schedule, and appointed a hearing examiner to conduct all further proceedings. The Order further allowed interested parties an opportunity to file comments and/or request a hearing on the application. Finally, the Order directed Staff to investigate the application and file its report or testimony on or before October 18, 2002.

On September 25, 2002, the Company filed its proof of service with the Clerk of the Commission. The Commission received no comments or requests for hearing. Staff filed its testimony on October 18, 2002, and the Company filed no response.¹

¹ Since there was no hearing in this matter and the Company filed no response to Staff’s testimony, this Report is based on Staff witness Stavrou’s prefiled testimony.

DISCUSSION

Schedule CO-G establishes the terms, conditions, and avoided energy and capacity cost payments governing the Company's power purchases from small QFs of 100 kW or less, pursuant to PURPA. At the present time, there are no QFs or pending applications from QFs, in the Company's Virginia jurisdiction, to which the Company's Schedule CO-G would apply. The Company proposes to eliminate capacity payments, revise contract duration terms, and revise monthly customer connection charges.

At the present time, the Company employs the Differential Revenue Requirements ("DRR") methodology to forecast its avoided costs. The avoided costs estimated using the DRR methodology are based on a multi-year plan containing the Company's official forecast of energy sales, peak loads, and supply-side resources, including installed capacity, required reserve margins, and reliability levels that the Company anticipates during the planning horizon to satisfy forecasted electricity demand. The Company files this plan with the Commission.

The Company has changed the methodology previously used to estimate its avoided energy costs and no longer offers avoided capacity payments. Instead, the Company proposes an avoided cost energy payment to cogenerators and small power producers based on market-determined firm energy prices from the PJM Interconnection wholesale electric market region. Because it will no longer build generation, the Company proposes to eliminate a separate capacity payment component. The Company maintains that QFs that qualify under Schedule CO-G have too small a design capacity to have significant value in the PJM capacity market. Further, the Company states that PJM prices used to estimate its avoided costs already contain an intrinsic capacity payment component.

As noted above, the Company has restructured and no longer owns generating facilities.² From now on, the Company will purchase from the market the energy and capacity it requires to supply its customers. Therefore, the Company's future avoided costs will be determined by the cost of its avoided market purchases of power.

Staff witness Stavrou confirms that the methodology used by the Company to forecast avoided firm energy costs is appropriate to forecast market prices in commodity markets. The Company based its forecast of avoided energy payments on a schedule of forward prices for on-peak, firm energy, in the PJM western hub market. Because forward PJM off-peak firm energy prices are not published, the Company estimated these prices by setting Schedule CO-G off-peak energy rates equal to the 2001 locational marginal prices at the PJM-AP interface.

Staff believes the methodology used by the Company to forecast firm energy prices is acceptable for the purposes of the present case. In the future, Staff believes the Company should obtain market price data from sources listed in the Commission's Final Order in Case No.

² By Order dated July 11, 2000, the Commission approved Potomac Edison's plan to transfer its generating units to an affiliate. *Application of The Potomac Edison Company d/b/a Allegheny Power*, for approval of a functional separation plan, Case No. PUE-2000-00280, 2000 S.C.C. Ann. Rep. 530.

PUE-2001-00306³ and modified by its Final Order of October 11, 2002, and perform calculations generally consistent with the calculations set forth in the Final Order of October 11, 2002. Staff further believes that, when appropriate, the market price information should be adjusted to reflect the fact that the electrical production will take place in the Company's Virginia service territory rather than at the price points reflected in the market data.

The Company proposes the following avoided cost payments to QFs:

	Proposed Rates		Existing Rates
Energy	Peak Season	Non-peak Season	
On-Peak	5.377¢/kWh	3.269¢/kWh	1.657¢/kWh
Off-Peak	2.221¢/kWh	2.221¢/kWh	1.535¢/kWh
All hours	3.066¢/kWh	3.066¢/kWh	1.600¢/kWh
Capacity	Not Offered	Not Offered	0.587¢/kWh

The peak season includes the months of June, July, and August. The other months of the year constitute the non-peak season. The Company's proposed rates are market based and are obviously higher than existing rates. Although the Company did not propose offering a separate avoided capacity payment, the proposed avoided cost payments compensate for the omission of a separate capacity payment. Overall, Staff agrees that the avoided cost estimates are reasonable.

Under the current tariff, QFs delivering firm power at a single delivery point with recording time-of-use metering equipment may obtain firm capacity contracts ranging from five to thirty years. The Company proposes to offer contracts with a maximum duration of three years and update avoided cost rates annually using market prices. Staff supports this change because the Company will require more flexibility in adapting its costs to market conditions.

The Company proposes updates and changes to its customer and metering charges. These charges are based on the costs of metering and the general administration of purchases from QFs. Such costs include operation and maintenance expenses of the meter equipment, material and supplies, administrative and general overhead, customer accounting and meter reading, check processing, and computer costs. Schedule CO-G currently contains separate connection charges for basic meters and recording time-of-use meters. The Company proposes to eliminate simple time-of-use meters. Staff does not object to the elimination of simple time-of-use meters.

The Company proposes the following monthly connection charges:

Meter Type	Proposed	Current	Increase
Basic	\$10.43	\$12.44	-\$2.01
Time-of-use	Not Offered		
Recording Time-of-Use	\$41.55	\$40.31	\$1.24

³ *Commonwealth of Virginia At the relation of the State Corporation Commission, Ex Parte: In the matter of considering requirements relating to wires charges pursuant to the Virginia Electric Utility Restructuring Act.*

The changes in interconnection charges are due to lower material and installation costs for meter equipment and decreases in overhead and administration costs. The increase in the recording time-of-use meter connection charge is due to an increase in data processing costs. Staff believes that these charges are cost based and, therefore, appropriate.

Overall, Staff believes the Company's proposed Schedule CO-G is reasonable and recommends approval. However, in view of the persistent uncertainty facing the Company and electric utilities as a whole, Staff recommends that the Company continue to monitor the PJM energy and capacity markets and further refine its market forecasting methodology as the PJM markets continue to develop. In that regard, the Company should update its Schedule CO-G rates at least biennially, and report on the state of the PJM markets at the time of the filing. Finally, if the Company decides to enter into a purchase power contract exceeding three years or decides to build generating capacity, Staff requests that the Company report to Staff well in advance of such actions so that Staff may evaluate the effect of such changes on Schedule CO-G.

FINDINGS AND RECOMMENDATIONS

Based on the evidence in this case, **I FIND** that:

- (1) The Company's proposed avoided energy costs are reasonable and should be approved;
- (2) The Company's methodology used to forecast avoided firm energy costs and prices is appropriate for purposes of this case;
- (3) The Company should, in future cases, obtain market price data from the sources listed in the Commission's Final Order in Case No. PUE-2001-00306 and modified by Final Order of October 11, 2002;
- (4) The Company, when appropriate, should adjust market price information to reflect the fact that the electrical production will take place in the Company's Virginia service territory rather than at the price points reflected in the market data;
- (5) The Company's proposed contract terms are reasonable and should be approved;
- (6) The Company's proposed updates to the customer and metering charges are reasonable and should be approved;
- (7) The Company's proposed monthly connection charges are reasonable and should be approved;
- (8) The Company should continue to monitor the PJM energy and capacity markets and further refine its market forecasting methodology;

(9) The Company should update its Schedule CO-G rates at least biennially, and report on the state of the PJM markets at the time of filing; and

(10) If the Company decides to enter into a purchase power contract exceeding three years or decides to build generating capacity, it should report such events to Staff well in advance of the execution of such events.

I therefore **RECOMMEND** the Commission enter an order that:

- (1) ***ADOPTS*** the findings contained herein;
- (2) ***APPROVES*** the Company's proposed Schedule CO-G; and
- (3) ***DISMISSES*** this case from the Commission's docket of active cases.

COMMENTS

The parties are advised that any comments (Section 12.1-31 of the Code of Virginia and 5 VAC 5-20-120 C) to this Report must be filed with the Clerk of the Commission in writing, in an original and fifteen (15) copies, within twenty-one (21) days from the date hereof. The mailing address to which any such filing must be sent is Document Control Center, P.O. Box 2118, Richmond, Virginia 23218. Any party filing such comments shall attach a certificate to the foot of such document certifying that copies have been mailed or delivered to all counsel of record and any such party not represented by counsel.

Respectfully submitted,

Howard P. Anderson, Jr.
Hearing Examiner